Supreme Court, U.S.
FILED
OCT 20 1971
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-220

MORTIMER M. CAPLIN, Trustee in Reorganization of WEBB & KNAPP, INC., on behalf of debentureholders under a trust indenture of Webb & Knapp, Inc. to The Marine Midland Trust Company of New York, trustee, dated as of June 1, 1954,

Petitioner,

—against—

THE MARINE MIDLAND GRACE TRUST COMPANY OF NEW YORK,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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October 20, 1971

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Preliminary Statement

This brief is submitted in opposition to a petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit seeking review of a judgment of that Court which affirmed orders of the United States District Court for the Southern District of New York dismissing a complaint and counterclaim to a proof of claim in bankruptcy, holding that in each instance the petitioner had

failed to state a claim upon which relief could be granted and failed to satisfy the real party in interest requirement of Rule 17(a), Federal Rules of Civil Procedure.

Question Presented

May a trustee in reorganization of a debtor pursuant to Chapter X of the Bankruptcy Act prosecute on behalf of debentureholders a negligence cause of action in which the debtor has no interest, where any recovery admittedly would be paid to debentureholders, not to the debtor, and would not affect any plan of reorganization, and where the debentureholders themselves are prosecuting the very same claims on their own behalf in actions pending in both the federal and the state courts of New York?

Statement of the Case

For only the fourth time since the Trust Indenture Act was passed in 1939, a federal Court of Appeals has considered the question of the standing of a trustee in reorganization to assert claims against an indenture trustee on behalf of a class of debentureholders rather than for the debtor. In a comprehensive opinion synthesizing the three previous holdings, the Court of Appeals for the Second Circuit found, as it had done twenty-eight years previously, that debentureholders, and not the trustee, had standing on the facts presented.

On or about June 1, 1954, Webb & Knapp, Inc. and Marine Midland Grace Trust Company of New York ("Marine Midland"), as indenture trustee, executed an indenture providing for the issuance by Webb & Knapp of 5% Sinking Fund Debentures due June 1, 1974, in the

aggregate principal amount of $8,607,600, of which the principal amount of $4,298,200 remains outstanding.

In the indenture, among other things, Webb & Knapp agreed to a negative covenant that it would not incur or assume certain forms of new indebtedness or purchase interests in real property unless it and its "affiliated group" of companies maintained a specified ratio of certain assets to particular liabilities.

In each of the years between 1954 and 1964, pursuant to the indenture, Webb & Knapp filed an officers' compliance certificate with Marine Midland stating that they had not obtained knowledge of any default by Webb & Knapp under the indenture. In addition, Webb & Knapp filed annual certificates during these years specifically affirming the company's compliance with the negative covenant pertaining to asset/liability ratios. The indenture expressly provided that in the absence of bad faith the Trustee could conclusively rely upon the truth of statements contained in officers' certificates delivered to it.

On May 7, 1965, Marine Midland, as indenture trustee, filed a petition for reorganization against Webb & Knapp. The petitioner herein was appointed trustee in reorganization pursuant to the Bankruptcy Act, 11 U.S.C. §§ 1 *et seq.* Thereafter, the petitioner commenced a plenary action against Marine Midland and, separately, asserted a counterclaim and objection to Marine Midland's proof of claim for its trustee fees, together with a motion to compel an accounting by the bank. All of these asserted that Marine Midland had negligently failed to enforce the negative covenant concerning Webb & Knapp's assets ratio and thereby damaged the debentureholders whose securities remained outstanding in 1964.

Actions based upon the very same facts also are being prosecuted by the debentureholders themselves. One of these, pending in the New York state courts, is maintained by a debentureholder on behalf of himself and "all other present and former holders" and asserts negligence by Marine Midland in failing to enforce the assets/liabilities ratio covenant.

Another, pending in a New York federal district court, has been brought by a debentureholder suing individually, as chairman of a Webb & Knapp debentureholders' "Protective Committee," and on behalf of all purchasers, holders and sellers of the debentures similarly situated. The federal action asserts various claims against Marine Midland and other defendants, including the same claim as that asserted by the petitioner based upon alleged negligent failure by Marine Midland to enforce the negative covenant.

Finally, yet another state action is pending on behalf of a debentureholder in his individual capacity.

No claim is made by either the petitioner trustee, or by the debentureholders in their federal and state court actions, that Marine Midland mishandled or even held any funds or other property whatsoever of the debtor in connection with the indenture. None was ever held by Marine Midland, since the debentures were unsecured.

In the present case, the District Court dismissed the petitioner's plenary action and his counterclaim and motion, holding that the matter of the trustee's lack of standing to sue on rights of action belonging to debentureholders, and not to the debtor in reorganization, had been determined long ago by the Second Circuit in *Clarke* v. *Chase National Bank*, 137 F. 2d 797 (2d Cir. 1943).

Two judges of the Court of Appeals panel which initially considered the petitioner's appeal disapproved of the District Court's orders, but since such an outcome would have required the overruling of *Clarke*, the case was referred to the entire court, sitting *en banc*. After careful analysis of the original precedent, and the subsequent authorities which petitioner maintained raised inconsistencies, the Court of Appeals reconciled the holdings in a 5-2 opinion which adhered to the *Clarke* result. *Caplin* v. *Marine Midland Grace Trust Co. of New York*, 439 F. 2d 118 (2d Cir. 1971).

Reasons for Denying the Petition

I. Lacking express statutory authorization to sue, petitioner claims he should be allowed to sue, nevertheless, to protect hypothetically uninformed debentureholders, although both state and federal actions brought by debentureholders in behalf of all present and former holders are pending.

In his petition, which is supported without significant elaboration by the Securities and Exchange Commission, Caplin invites a *de novo* inquiry by this Court into the question of the extent of statutory limitations upon a Chapter X trustee's authority to engage in litigation in support of claims other than those of the bankrupt estate. The petition urges extensive examination of the respective legislative purposes of and the various interrelationships between the Bankruptcy Act and the Trust Indenture Act of 1939.

For a variety of hypothetical reasons, the petitioner contends that he should be found to have standing to maintain the debentureholders' claims based on the indenture trus-

tee's alleged failure to enforce a negative covenant. He argues that the debentureholders themselves might find such actions difficult to prosecute because of their lack of ready access to the debtor's records, and he urges the possibility that they might be unlikely even to realize that a claim for relief existed (Pet. 5).

But these hypotheses advanced in support of the petition plainly ignore the facts of this case, in which representatives of the actual parties allegedly injured—the Webb & Knapp debentureholders themselves—already have brought three separate actions in their own behalf based on the same facts. Although the petitioner asks this Court to determine that a Chapter X trustee is "the logical person" to prosecute volunteer actions for hampered or uninformed debentureholders in the light of legislative intent that such persons receive some appropriate protection of their rights, such a hypothetical question is not properly presented by his own petition.

The petitioner does not contend that Marine Midland has in any way mishandled any assets of the bankrupt estate, nor can he argue that recovery of damages by the debentureholders would affect his ability to devise a plan of reorganization for Webb & Knapp. Instead, he argues essentially that the legislative history of two federal statutes should be read to entitle a Chapter X trustee to use the assets of the estate to serve as a sort of champion of last resort for groups of debentureholders. Since he already has certain information about the bankrupt's affairs, petitioner contends, he is a "logical person" to represent them.

But in view of the purely hypothetical nature of these arguments, no substantial question is presented for deci-

sion by this Court. The issue raised in the petition had been thought so well resolved that it was not ruled upon for fifteen years between the last prior appellate decision and the date this action was filed, and the facts of the present case demonstrate that the long-established doctrine is in accord with practical expectations as well as legislative intentions.

In view of debentureholders' willingness and ability to maintain actions in their own behalf, the hypothetical case posed by the petitioner as an example of a situation requiring redress by this Court simply has not arisen.

II. No conflict exists between Circuits or within any Circuit with respect to the issue presented.

This case involves the only instance during the past fifteen years in which a Chapter X trustee has pressed an attempt to assert claims against an indenture trustee on behalf of a group of debentureholders. After full consideration of the only three other appellate cases ever to deal with the problem—including two which came before the very Court of Appeals which affirmed dismissal of this action—the court *en banc* concluded that all were consistent in their requirement that the petitioner could not maintain an action such as this.

The court below adhered to its prior determination that debentureholders' claims for negligence against an indenture trustee for breach of a negative covenant are not part of the property of the bankrupt corporation and have nothing to do with a Chapter X trustee's proper responsibilities. *Clarke* v. *Chase National Bank, supra.*

The *Clarke* opinion was considered by the Third Circuit when a similar case arose a decade later, *In re Solar Mfg. Corp.*, 200 F.2d 327 (3d Cir. 1952), *cert. denied sub nom. Marine Midland Trust Co.* v. *McGirl*, 345 U.S. 940 (1953). But in that instance, a Chapter X trustee argued that an indenture trustee had negligently failed to keep *funds of the debtor itself* in trust, entitling him to sue "for the restoration of trust funds." *Id.* at 332. The Third Circuit pointedly commented that these facts differed from those present in *Clarke* and noted that its result was perfectly consistent with the Second Circuit's reasoning. *Id.* at 332, n. 6.

In the present case, decided almost two decades later, petitioner argued to the Second Circuit that its own *Clarke* reasoning actually *conflicted* with the Third Circuit's holding. But the court below disagreed, noting instead that it found no distinction other than that dictated by altogether different facts. The Second Circuit expressly affirmed that it also did not regard *Solar* as in conflict with *Clarke*. *Caplin* v. *Marine Midland Grace Trust Co. of New York*, *supra*, 439 F.2d at 122, n. 4.

Thus *both circuits agree* that there is *no conflict* between their holdings.

In addition, petitioner argued below that the *Clarke* rule conflicted with a later holding of the Second Circuit itself

in *Prudence-Bonds Corp.* v. *State Street Trust Co.*, 202 F.2d 555 (2d Cir.), *cert. denied*, 346 U.S. 835 (1953).

The *Prudence-Bonds* opinion was written by Judge Learned Hand, who himself had dissented in *Clarke*. Although Judge Hand's opinion does not refer to the earlier *Clarke* case, the Second Circuit examined the two decisions in detail and concluded that the later one did not tacitly overrule *Clarke*. "Far from being indistinguishable" as petitioner had urged, the court below held, "*Prudence-Bonds* differs from this case and from *Clarke* on the very ground Judge Hand was at such pains to clarify." 439 F.2d at 122. (In *Prudence-Bonds*, as in *Solar*, the Chapter X trustee asserted a claim to property belonging to the debtor.)

This reconciliation of any possible difference between its 1943 *Clarke* holding and the 1953 *Prudence-Bonds* decision occurred, as was appropriate, in an *en banc* opinion by the entire Second Circuit. Consequently, there can be no remaining "conflict" within the Second Circuit as petitioner contends.

CONCLUSION

The petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be denied.

Respectfully submitted,

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